Supreme Court, U.S.
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No. 04-

IN THE

Supreme Court of the United States

NATIONAL LOAN INVESTORS, L.P.,

Petitioner,

v.

MICHAEL E. and TOMMYE DENOFA,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether, under 11 U.S.C. § 506(b), the holder of an allowed secured claim is entitled to post-petition interest where the value of all property securing the claim exceeds the amount of the allowed secured claim, but the value of property in which the debtor's estate has an interest does not exceed the amount of the allowed secured claim.

2. Did the Third Circuit correctly hold that a lender, which who receives a payment from a non-debtor co-guarantor, must apply that payment to the principal obligation of a co-guarantor who has filed for bankruptcy protection; or may the lender apply the payment to interest which accrued on the non-debtor co-guarantor's obligation after the debtor's bankruptcy filing?

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Petitioner National Loan Investors, L.P. (the "Petitioner" or "NLI"), the Appellant below, respectfully prays that a writ of certiorari issue to review a decision and order of the United States Court of Appeals for the Third Circuit entered February 17, 2005 in this matter. In that decision, the Third Circuit affirmed a decision and order of the United States District Court for the District of New Jersey dated January 27, 2004. The District Court's decision reversed an order which granted partial summary judgment to NLI, entered by the United States Bankruptcy Court on October 16, 2002.

NLI filed a timely petition for panel rehearing with the Third Circuit pursuant to Federal Rule of Appellate Procedure 40, which was denied on March 16, 2005.

OPINIONS BELOW

The March 16, 2005 Order which denied NLI's petition for panel rehearing is unreported and is reproduced hereto as Appendix "H." The February 17, 2005 decision of the United States Court of Appeals for the Third Circuit, which affirmed a decision and order of the United States District Court for the District of New Jersey, is unreported and is reproduced hereto as Appendix "A." That decision is available on Westlaw at 2005 WL 375703. The February 17, 2005 order of the United States Court of Appeals for the Third Circuit is unreported and is reproduced hereto as Appendix "B."

The March 3, 2004 Order of the United States District Court, denying NLI's motion for reconsideration of its January 27, 2004 decision and order, is unreported and is reproduced hereto as Appendix "C." The January 27, 2004 decision of the United States District Court, reversing a

decision and order of the United States Bankruptcy Court for the District of New Jersey, is unreported and is reproduced hereto as Appendix "D." The January 27, 2004 order of the United States District Court is unreported and is reproduced hereto as Appendix "E."

The October 16, 2002 decision of the United States Bankruptcy Court for the District of New Jersey, granting the Petitioner partial summary judgment, is unreported, and is reproduced hereto as Exhibit "F." The October 16, 2002 decision of the United States Bankruptcy Court for the District of New Jersey is unreported, and is reproduced hereto as Exhibit "G."

STATEMENT OF JURISDICTION

The jurisdiction of this Court to review the February 17, 2005 decision of the Third Circuit is invoked under 28 U.S.C. § 1254. This Petition for Certiorari is timely filed as it is filed within ninety days after the Third Circuit's March 16, 2005 Order denying NLI's petition for panel rehearing pursuant to Federal Rule of Appellate Procedure 40.

STATUTORY PROVISIONS INVOLVED

Section 506(b) of Title 11 of the United States Code (the "Bankruptcy Code") provides:

> To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

STATEMENT OF THE CASE

A. Factual Background

NLI's Petition involves a question of statutory interpretation under Title 11 of the United States Code (the "Bankruptcy Code") which arises frequently in Bankruptcy Courts, and which has been subject to varying holdings. This case provides an ideal vehicle for this Court to resolve this issue decisively, and to provide for uniformity of application currently lacking under the statutory provision at issue, 11 U.S.C. § 506(b).

National Loan Investors, L.P. ("NLI") filed a proof of claim against the Chapter 11 Bankruptcy Estate of Michael E. and Tommye DeNofa (the "DeNofas"), which included a principal amount of $323,615.69 and post-petition interest thereon. The basis for NLI's claim was money loaned to DAK Manufacturing Corporation ("DAK") by NLI's predecessor-in-interest. Steven Katz ("Mr. Katz") and Michael DeNofa guaranteed the loan. To secure the loan, DAK granted the lender a mortgage and security interest in property owned by DAK. To further secure the debt, Mr. Katz and his wife, and Mr. DeNofa and his wife, each conveyed a mortgage on their homes which served as part of the lender's collateral.

NLI sought post-judgment interest on its proof of claim against the DeNofas' under the terms of 11 U.S.C. § 506(b), which allows for an award of post-judgment interest where an "allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim." The DeNofas objected to the NLI proof of claim for a number of reasons. Of relevance here, the DeNofas conceded that the value of all property securing the NLI's allowed secured

claim exceeded the amount of that allowed secured claim. Nonetheless, the DeNofas objected to an award of interest to NLI because the value of the property in which the Debtors' Estate had an interest was less that NLI's allowed secured claim. The DeNofas argued that, under 11 U.S.C. § 506(b), a bankruptcy court may only look to property in which a debtor's estate has an interest to determine whether the holder of an allowed secured claim is entitled to post-petition interest.

The Bankruptcy Court rejected the DeNofas' argument, holding that the precise language of Section 506(b) required, for purposes of determining whether a holder of an allowed secured claim was entitled to post-petition interest, the aggregation of all property securing the claim. Therefore, the Bankruptcy Court held that since the value of all property securing the NLI allowed secured claim exceeded the value of such claim, NLI was entitled to post-petition interest in accordance with the precise provisions of that statute. The Bankruptcy Court cited to the decision in *In re Arnett*, 156 B.R. 366, 367 (Bankr. D. Conn. 1993) to support its decision.

The DeNofas appealed the Bankruptcy Court's decision to the United States District Court for the District of New Jersey, which treated the Notice of Appeal as a request for interlocutory review. The District Court reversed the Bankruptcy Court, holding that, for purposes of determining whether a creditor is entitled to post-petition interest under 11 U.S.C. § 506(b), a court may only consider the value of property in which a debtor's estate has an interest. For its part, the District Court disregarded the Bankruptcy Court's reliance on *Arnett*, and cited to the decision in *In re Stephen Shields Pardue*, 143 B.R. 434 (Bankr. D. Tex. 1992) in

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support of its holding. NLI appealed this ruling to the United States Court of Appeals for the Third Circuit, arguing that Section 506(b) speaks of all "property" not just "property in which the estate has an interest." The Third Circuit affirmed the District Court's ruling.

NLI now seeks this Court's review of a substantial question which split the courts below in their rulings. The holdings of the District Court and the Third Circuit are inconsistent with the precise language of Section 506(b). The District Court and the Third Circuit wrongfully denied to NLI the post-petition interest which had been awarded by the Bankruptcy Court. The Bankruptcy Court correctly determined that it was not disputed that the value of all property securing NLI's allowed secured claim exceeded the value of the claim, and that NLI was entitled to post-petition interest under 11 U.S.C. § 506(b). The District Court and the Third Circuit, however, refused to look to the value of all property securing NLI's allowed secured claim. Even though no such limitation is found within Section 506(b), these courts only considered the property in which the Debtors' Estate had an interest in ruling that NLI was not entitled to post-petition interest.

B. Statement of Federal Jurisdiction

The DeNofas' Adversary Proceeding, objecting to NLI's proof of claim, was filed before the Bankruptcy Court which, pursuant to 28 U.S.C. § 157(b)(2)(B), possessed "core" jurisdiction over the DeNofas' complaint pertaining to the allowance or disallowance of a claim against the DeNofas' bankruptcy estate. The United States District Court for the District of New Jersey possessed appellate jurisdiction

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of the bankruptcy proceedings pursuant to 28 U.S.C. § 158(a)(2). The United States Court of Appeals for the Third Circuit possessed appellate jurisdiction of the District Court proceedings pursuant to 28 U.S.C. § 158(d).

REASONS FOR THE GRANTING THE PETITION

I. Under Section 506(b), The Issue Of Whether An Allowed Secured Claim Is Entitled To Post-Petition Interest Is Resolved By Looking To All Property Securing The Claim In Order To Determine Whether The Claim Is Oversecured.

The first issue before the Court concerns the proper application of 11 U.S.C. § 506(b). NLI holds an allowed secured claim against the DeNofas' estate. NLI's claim was secured against property of the Debtors' estate, specifically their residence. The NLI claim was also secured by other property in which the Debtors' did not have a direct ownership interest. The DeNofas do not dispute that the value of all collateral securing NLI's claim against the DeNofas exceeded the amount of NLI's claim. Since NLI's principal claim is secured by property, the value of which is greater than the amount of its claim, NLI argued to the Bankruptcy Court that, under 11 U.S.C. § 506(b), NLI was entitled to post-petition interest on its claim, as well as any reasonable fees, costs or charges, as provided for in the DeNofa Guaranty. This is the result required by the precise, unambiguous language of 11 U.S.C. § 506(b). The Bankruptcy Court sustained NLI's argument.

The District Court reversed the Bankruptcy Court on this issue, and the Third Circuit affirmed that ruling. These courts held that section 506(b) authorizes an award of post-petition interest only where the creditor's claim is secured against

property in which the Debtors' estate has an interest, the value of which is greater that the amount of the creditor's claim. These courts thus concluded that the Bankruptcy Court erred when it considered collateral other than the property in which the Debtors' estate has an interest for purposes of determining whether NLI was entitled to post-petition interest. In addition to the DeNofas' residence, NLI's claim was secured against property owned by DAK Manufacturing, the principal obligor ("DAK") and Stephen Katz, a co-guarantor ("Mr. Katz"). But the District Court and the Third Circuit declined to consider that property in making its analysis under section 506(b).

The Bankruptcy Court was correct. Section 506(b) does not limit the valuation inquiry to property in which the estate has an interest. The statute is unambiguous:

> To the extent that an allowed secured claim is secured by property, the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

As properly held by the Bankruptcy Court, Congress used the term "property" in section 506(b) without limiting that term. The Third Circuit's construction of section 506(b) imposes a limitation on the term "property" that Congress did not. As a result, the Third Circuit, for valuation purposes under section 506(b), did not consider the "property" securing the NLI loan, but only the "property in which the estate had an interest," in violation of the statute.

If Congress had intended to limit the court's inquiry under section 506(b) to only that property in which the estate had an interest, it would have said so. Instead of drafting the statute that it did, the statute would read as follows:

> To the extent that an allowed secured claim is secured by property **[in which the debtor has an interest]**, the value of which .. . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest upon the claim, and any reasonable fees, costs or charges provided for under the agreement under which the claim arose.

(the bold and bracketed language *not* part of the actual statute). The Bankruptcy Court applied a statute that did not include the bold and bracketed language found in the above quotation. The Bankruptcy Court applied the statute as drafted, and was improperly reversed by the two appellate courts.

The cardinal rule of statutory interpretation is that where a statute is plain and unambiguous on its face, a court must apply the statute as drafted. *Dow Chemical Company v. United States Environmental Protection Agency*, 635 F.2d 559, 561 (6th Cir.), *cert. denied*, 452 U.S. 939, 101 S. Ct. 3082, 69 L. Ed. 2d 953 (1981) (*citing Southeastern Community College v. Davis*, 442 U.S. 397, 405, 99 S. Ct. 2361, 2366, 60 L. Ed. 2d 980 (1979) and *United States v. Oregon*, 366 U.S. 643, 648, 81 S. Ct. 1271, 1280, 6 L. Ed. 575 (1961) ("It is, however, a cardinal rule of statutory interpretation that the courts do not turn to legislative history

to shed light on the meaning of easily understandable and unambiguous statutory enactments."). This Court has held:

> In any event, canons of construction are no more than rules of thumb that help courts determine the meaning of legislation, and in interpreting a statute a court should always turn first to one, cardinal canon before all others. We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there. *See, e.g., United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241-242, 109 S.Ct. 1026, 1030-1031, 103 L.Ed.2d 290 (1989); *United States v. Goldenberg*, 168 U.S. 95, 102-103, 18 S.Ct. 3, 4, 42 L.Ed. 394 (1897); *Oneale v. Thornton*, 6 Cranch 53, 68, 3 L.Ed. 150 (1810). When the words of a statute are unambiguous, then, this first canon is also the last: "judicial inquiry is complete." *Rubin v. United States*, 449 U.S. 424, 430, 101 S.Ct. 698, 701, 66 L.Ed.2d 633 (1981); *see also Ron Pair Enterprises, supra,* 489 U.S., at 241, 109 S.Ct., at 1030.

Connecticut National Bank v. Germain, 503 U.S. 249, 253-54, 112 S. Ct. 1146, 1149, 117 L. Ed. 2d 391 (1992).

Under this rule of statutory construction fixed by the Supreme Court, the Third Circuit's first duty was to consider the language of Section 506(b) and, if found to be unambiguous, to apply the statute as written without further analysis. Despite the clarity of Section 506(b), the Third Circuit nonetheless engaged in a forbidden interpretative analysis. By looking to the language of Section 506(a), and by thereafter treating the two distinct subsections as if they

were one, the Third Circuit reached an interpretation of Section 506(b) inconsistent with its precise terms.

Simply stated, under Section 506(b), the question of whether interest is allowed to a holder of an "allowed secured claim" is resolved by whether such claim "is secured by property the value of which ... is greater than the amount of such claim." Congress specifically stated that the measuring rod was the value of "property" – not just "property of the estate" – which serves as security for the allowed secured claim. The Third Circuit engrafted a limitation in Section 506(b) that Congress did not.

The Third Circuit found justification for this conclusion due to the presence of the term "allowed secured claim" in Section 506(b). This Court reasoned, correctly, that this term was defined by Section 506(a), which provides that an "allowed secured claim" is one secured by "property in which the estate has an interest ... to the extent of the value of such creditor's interest in the estate's interest in such property." From this, the Court reasoned, incorrectly, "the 'allowed secured claim' of NLI that we must examine for purposes of post-petition interest under § 506(b) is limited to the extent of the value of the DeNofas' bankruptcy estate which secures it." (6a). The Third Circuit imported a limitation found in Section 506(a) into Section 506(b), due the presence in both sections of the term "allowed secured claim."

The Third Circuit's error was its failure to appreciate that Section 506(a) and Section 506(b) have different purposes. Section 506(a) determines whether a creditor is a holder of an allowed secured claim. Section 506(b) determines whether a holder of an allowed secured claim is

entitled to post-petition interest. In order for a creditor to reach the analysis under Section 506(b), it must first pass the test under Section 506(a), meaning that he must be a holder of an allowed secured claim. That is the only significance of the use of the term "allowed secured claim" in both sections.

This is best understood by consideration of the actual facts of this case. On the filing date of the DeNofas' bankruptcy, the DeNofas' were indebted in the amount of $323,615.59 to NLI's predecessor, as determined by the Bankruptcy Court. Their home was worth $275,000 at that time.

Initially, the issue under Section 506(a) was whether NLI or its predecessor was the holder of an allowed secured claim. For purposes of that analysis, the answer is that NLI was the holder of an allowed secured claim in the amount of $275,000, since the "property in which the estate has an interest . . . to the extent of the value of such creditor's interest in the estate's interest in such property" was the value of the DeNofas' residence, or $275,000. The balance of the creditor's claim was not secured, and thus became an unsecured claim against the DeNofas' estate. *See In re Indian Palms Assocs., Ltd.*, 61 F.3d 197, 201 n.6 (3d Cir. 1995) (a creditor holds an allowed secured claim to the extent there is equity in collateral that is property of the estate, and holds an unsecured claim for the balance). Thus, at the end of the inquiry under Section 506(a), NLI's predecessor was the holder of an "allowed secured claim" in the amount of $275,000, and the holder of an unsecured claim for the balance of its claim.

Since NLI's predecessor was the holder of an allowed secured claim, the next step was the determination of whether it was entitled to post-petition interest, which is the analysis under Section 506(b). Under that section, the holder of an allowed secured claim is entitled to post-petition interest "[t]o the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim." For purposes of this analysis, a holder of an allowed secured claim is entitled to post-petition interest on that claim where it is secured by property – not just property in which the estate has an interest – which is greater in value than the amount of the allowed secured claim. Here, NLI's allowed secured claim was $275,000, and the value of all property securing that claim exceeded $1,026,817. NLI was thus entitled to post-petition interest on its allowed secured claim according to the precise terms of Section 506(b).

The Third Circuit reasoned that, because the issue of whether NLI was the holder of an allowed secured claim under Section 506(a) was determined by reference to property in which the estate had an interest, the issue of whether it was entitled to post-petition interest on its allowed secured claim also had to be resolved by reference to property in which the estate had an interest. But, as demonstrated above, the second premise does not follow logically or necessarily from the first. Congress specifically used the terminology "property in which the estate has an interest" in Section 506(a). It did not in Section 506(b). This Court must presume that Congress intended the distinction in language between the two sections, and the distinction must serve some purpose.

The Bankruptcy Court's construction of section 506(b) is not only consistent with the express terms employed by Congress, but it does not cause any absurd results. The

appellate courts, in the course of their discussions, never addressed whether the statute was plain and unambiguous on its face, even though resort to that canon of construction should have been the beginning and end of their inquiries. Perhaps the best reason for reviewing, and reversing the opinion below, was offered by the Third Circuit itself:

> Section 506(a) refers to "property in which the estate has an interest," while § 506(b) refers only to "property" generally, unmodified by any surrounding terms. As such, one is tempted to follow the interpretive principle that "'where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.'" *KP Permanent Make-Up, Inc. v. Lasting Impression I, Inc.*, — U.S. ——, 125 S.Ct. 542, 548, 160 L.Ed.2d 440 (2004) (*quoting Russello v. United States*, 464 U.S. 16, 23, 104 S.Ct. 296, 78 L.Ed.2d 17 (1983)). This principle "applies 'particularly when the two [provisions] are interrelated and closely positioned, both in fact being parts of the same statutory scheme.'" *Ki Se Lee v. Ashcroft*, 368 F.3d 218, 223 (3d Cir.2004) (citation omitted). Applying the principle here would seem to support NLI's contention — because Congress included "particular language" ("in which the estate has an interest") modifying "property" in § 506(a), but omitted that "particular language" modifying "property" in § 506(b), Congress intended the disparate exclusion, i.e., Congress intended to

> limit "property" to that belonging to the estate for purposes of § 506(a), but not to that belonging to the estate for purposes of § 506(b).

(5a).

Nonetheless, the Third Circuit veered from this principle because of its subjective estimation that "[s]ubsections (a) and (b) work closely together, and one cannot correctly understand and apply the latter before understanding and applying the former" (5a). While this observation may be true, it does not support the Third Circuit's interpretation at all. What should have impressed the Third Circuit is that Congress included language in one section of Section 506 that it did not include in the other; that the sections are inter-related and closely positioned; and that both sections are part of the same statutory scheme. *See Ki Se Lee v. Ashcroft*, 368 F.3d 218, 223 (3d Cir. 2004). In the end, it is not logical to conclude, as the Third Circuit did, that due to the use of the term "allowed secured claim" in subsections (a) and (b) of Section 542, property securing "an allowed secured claim" can be secured only by property in which the estate has an interest. An "allowed secured claim" can be and is often secured against non-debtor property. Lenders often seek collateral from more than one source, and rightfully consider all collateral to be security for its loan. In enacting section 506(b), Congress intended to protect the lender's expectation in this regard, as it the lender's expectation of being fully secured which induces its decision to lend in the first place. NLI's petition implicates vital public policy concerns which can be protected by this Court's issuance of a writ of certiorari, and its reversal of the Third Circuit's decision.

For instance, suppose that a bank makes a $1,000,000 loan to a corporate borrower which loan is guaranteed by the principal of the borrower. Further suppose that as security for the $1,000,000 loan, the borrower provides a mortgage on corporate property worth $950,000 and the guarantor provides a mortgage on his/her personal property valued at $950,000. In commercial terms, the $1,000,000 loan would be secured by collateral totaling $1,900,000, an abundantly over-secured loan. Further suppose that both the borrower and guarantor then file separate chapter 11 bankruptcy cases. Under the Third Circuit's interpretation of 11 U.S.C. § 506(b), upon the filing of the bankruptcy cases, this loan would be transformed from an over-secured loan to an under-secured loan as to each debtor. The bank would be prohibited from recovering post-petition interest and fees on the loan from either the borrower or the guarantor because of the judicial myth that the loan is under-secured. A literal reading of 11 U.S.C. § 506(b), as employed by the Bankruptcy Court and advanced by NLI, precludes the absurd results of this example.

II. NLI Rightfully Applied The Payment Made By The Co-Guarantor, Made In Order To Stay Execution On A Judgment Of Foreclosure Against The Co-Guarantor, To The Interest Obligation Of The Co-Guarantor; As A Result, The DeNofas Are Not Entitled To A Credit Toward Their Principal Obligation.

The Third Circuit resolved a critical issue in this case by way of a footnote at the conclusion of its opinion, as if there were nothing to decide. The court wrote:

> We will also affirm the District Court's application of the Katzes' settlement payment of $250,000 to the principal obligation of the loan debt. A creditor

> may only apply payments on a debt to post-petition interest and costs to the extent the debt is oversecured, and must otherwise apply payments to reduce the principal of the debt. *See In re Indian Palms Assocs., Ltd.*, 61 F.3d 197, 201 (3rd Cir. 1995). Unless interest accrues on a debt during bankruptcy, there are no "theories that would support the allocation of post-petition payments to something other than the reduction of the principal debt. *Id.* at 211. The District Court correctly concluded that NLI's claim as to the DeNofas was not oversecured and did not accrue post-petition interest, and therefore correctly applied the Katzes' payment to reduce the principal of the loan debt.

(6a n.2). The panel's decision in this regard ignores critical facts and, as a result, conflicts with settled principles of law. On this issue, the Third Circuit's decision is indefensibly and transparently wrong.

As the Third Circuit recognized, post-petition payments may be applied to interest where "interest accrues on a debt during bankruptcy." (6a). This circumstance is directly relevant to this case. Regardless of whether interest accrued on Mr. DeNofa's Guaranty post-petition, interest accrued post-petition on Mr. Katz's Guaranty. Mr. Katz was a non-debtor not entitled to the protections of the Bankruptcy Code. As of the date of NLI's standstill agreement with Mr. Katz, Mr. Katz owed NLI $1,025,597.77. Mr. Katz made a $250,000 payment toward that obligation, which NLI then applied toward interest, due from Mr. Katz. What NLI did was undoubtedly within its right under universally accepted law, as well as the loan documents.

In order to understand why this is so, this Court must return to the original loan transaction with DAK Manufacturing Corporation. ("DAK"). NLI's predecessor-in-interest entered into a loan agreement with DAK for a sum not to exceed $1,000,000. DAK's obligation was secured by a mortgage and security interest in property owned by DAK as well as mortgages on real property owned by the guarantors.

Both Mr. Katz and "Mr. DeNofa", DAK's owners, signed personal Guaranties, which were secured by mortgages in favor of the lender against their personal residences. When co-guarantors each personally guarantee the obligation of third person, each co-guarantor is independently liable for the full amount of the stated obligation. *See, e.g., Finagin v. Arkansas Development Finance Authority*, 355 Ark. 440, 451, 139 S.W.3d 797, 801 (2003); *Harris Trust and Savings Bank v. Olsen*, 745 F. Supp. 503, 508 (N.D. Ill. 1990). This means that both Mr. Katz and Mr. DeNofa were, at the outset, both independently liable for the full amount of the DAK obligation.

On the date the DeNofas filed for bankruptcy, Mr. DeNofa and Mr. Katz were still both independently liable for the DAK principal obligation, and their obligations were for equal amounts. According the Third Circuit, however, upon the filing of the DeNofas' bankruptcy petition, interest ceased to accrue on Mr. DeNofa's Guaranty obligation. The Third Circuit reasoned that NLI's claim against Mr. DeNofa on his Guaranty was under-secured as of the filing date of the DeNofas' bankruptcy; therefore, the accrual of interest on Mr. DeNofa's Guaranty obligation ceased upon the filing of the DeNofas' bankruptcy petition.

Of critical importance to this analysis, however, is that interest at all times continued to accrue on the obligations of the non-debtors, including Mr. Katz, even though interest may have ceased accruing on Mr. DeNofa's Guaranty obligation. This is so because the filing of a bankruptcy petition only acts to stay the accrual of interest of the *debtor* (if the loan is under-secured). Obligations of non-debtors, however, are not affected by a bankruptcy filing, and interest continues to accrue on their obligations, notwithstanding that a co-obligor has filed for bankruptcy.

At the time NLI entered into its standstill agreement with Mr. Katz, the Mr. Katz's obligation on his Guaranty exceeded $1,000,000 in principal and interest. Again, this is because the Bankruptcy Code did not stay the accrual of interest against Mr. Katz, a non-debtor. Mr. Katz *stipulated* as a term of his agreement with NLI that his obligation to NLI on his Guaranty exceeded $1,000,000. Mr. Katz consented to the entry of a final judgment of foreclosure in the amount of $1,025,597.77 and stipulated to a payment obligation to NLI for that amount. In exchange for a payment of $250,000, NLI agreed to stay execution on the foreclosure judgment. NLI then applied Mr. Katz's payment toward interest due that had accrued on the DAK loan obligations and consequently, on Mr. Katz's Guaranty.

The Third Circuit determined that Mr. Katz's settlement payment had to be applied against Mr. DeNofa's principal obligation. It reasoned that "unless interest accrues on a debt during bankruptcy, there are no 'theories that would support the allocation of post-petition payments to something other than a reduction of the principal debt.'" (6a n.2 (*quoting In re Indian Palms Assocs., Ltd.*, 61 F.3d 197, 201 (3d Cir. 1995)).

The error in the Court's analysis is that interest did continue to accrue post-petition on DAK's obligations and on Mr. Katz's Guaranty, even if interest did not accrue on Mr. DeNofa's Guaranty obligation. On the date of NLI's standstill agreement with Mr. Katz, DAK and Mr. Katz owed NLI the sum of $1,025,597.77, even though Mr. DeNofa's obligation remained fixed as of the date of the DeNofas' bankruptcy filing.

NLI applied the $250,000 payment toward interest due from Mr. Katz. In this regard, NLI's position was explicitly authorized by the terms of the Guaranty itself. Even the District Court recognized that the Loan Documents authorized NLI to apply Mr. Katz's payment as it did:

> Based on the Loan and Security Agreement and the Guaranties, the Court finds that Judge Steckroth's factual determination that the loan documents do not require NLI to apply the Katzes' payment to NLI's claim is not clearly erroneous; therefore, that finding must be upheld.

(43a). The District Court also highlighted that "[t]he DeNofas do not contest that the loan documents would allow a creditor to apply proceeds from disposition of collateral to interest, fees and other expenses." (44a).

In the Loan Documents, the creditor reserved the right to apply funds "from whatever source on account of the Liabilities" .. . "toward the payment of such Liabilities, and in such order of application, as the Bank may from time to time elect. . . ." (000078).[1] "Liabilities" was defined in the

1. This reference is to the Third Circuit record.

Guaranty to mean "all obligations of the Debtor to the Bank," meaning not just the principal advanced, but "*all* obligations of the Debtor to the Bank, howsoever created, arising or evidenced, whether direct or indirect, absolute or contingent, or now or hereafter existing, or due or to become due . . ." (*Id.*). Accordingly, NLI possessed the right under the loan documents to apply Mr. Katz's payment to any obligation from any of the obligors to NLI, including, at its election, to overdue interest. The Guaranty is drafted in terms of what the creditor "may" do and what it may "elect" to do, is permissive in nature, and was clearly drafted to afford the creditor as much discretion as possible in its application of funds received from "whatever source."

Consistent with the documents, NLI applied Mr. Katz payment to overdue interest on Mr. Katz's Guaranty. It is vital to recall, again, that interest continued to accrue post-petition on the obligations of DAK and Mr. Katz, even if interest ceased accruing on Mr. DeNofa's Guaranty. The fundamental error that the District Court made in reversing the Bankruptcy Court on this issue, and which the Third Circuit repeated, was that it applied Mr. Katz's payment to Mr. DeNofa's principal obligation under the mistaken belief that no interest accrued post-petition. That is just not correct. Interest accrued on Mr. Katz's obligation post-petition, and NLI rightfully applied the *Katz* payment to the *Katz* obligation.

The Third Circuit cited its prior decision in *In re Indian Palms Assocs., Ltd.*, 61 F.3d 197, 201 (3d Cir. 1995) for the holding reached in footnote two of the Opinion. But a careful evaluation of that decision serves to demonstrate why this Court's holding was incorrect. In *Indian Palms*, a bankruptcy court concluded that post-petition payments made by a *debtor*

during a bankruptcy proceeding were interest payments. *Id.* at 201. This determination was reversed on appeal due to the fact that no interest accrued post-petition on the *debtor's* obligation. In that case, however, there was no non-debtor obligor against whom interest continued to accrue after the filing of the debtor's bankruptcy petition. As this Court recognized, *Indian Palms* stands for the proposition that post-petition payments must be applied to the *debtor's* principal obligation "[u]nless interest accrues on a debt during bankruptcy. . . ." (Opinion, p. 6 n.2).

Here, interest did accrue post-petition on an obligation – DAK's obligation and Mr. Katz's Guaranty. NLI thus properly applied Mr. Katz's payment toward his on-going interest obligations in a manner consistent with NLI's rights under the Loan Documents. The Third Circuit senselessly undermined NLI's lawful rights in the loan documents and destroyed the value of the Katz settlement by its ruling on this issue, which NLI respectfully suggests is manifestly incorrect, and totally inconsistent with universally accepted law. The Third Circuit effectively released the DeNofas from their mortgage, without NLI receiving any offsetting payment on the mortgage, and thus transformed a fully secured corporate loan into a separate, non-interest bearing guaranty debt. This outcome was not the intention of the parties when the debt originated, and it was not the intention of Mr. Katz or NLI at the time of their standstill agreement. NLI therefore requests this Court to grant its Petition for Certiorari on this issue.

CONCLUSION

For the foregoing reasons, the Petitioner respectfully requests that this Court issue a Writ of Certiorari to the United States Court of Appeals for the Third Circuit, and that upon its consideration, that it reverse the opinion of the Third Circuit, restore the decision of the Bankruptcy Court, and remand to the United States Bankruptcy Court for further proceedings.

Respectfully submitted,

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